# INDEX



## CITATIONS

# In the Supreme Court of the United States

OCTOBER TERM, 1960

No. 810

ISADORE BLAU, ETC., PETITIONER

*v.*

ROBERT LEHMAN, ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

### OPINIONS BELOW

The opinions of the court of appeals (Pet. 1a–22a and 23a–29a) have not yet been reported. The opinion of the district court (R. 149a–157a) [1] is reported at 173 F. Supp. 590.

### JURISDICTION

The judgment of the court of appeals was entered on December 20, 1960 (Pet. 32a–33a). Petitioner's motion for rehearing was denied by the court *en banc* on February 21, 1960 (Pet. 23a–24a). The petition

[1] "R." refers to the joint appendix filed in the court of appeals.

for a writ of certiorari was filed on March 14, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Where one partner of a firm which has been trading in a corporation's stock registered on a national securities exchange is a director of the corporation, may the corporation recover the entire "short-swing" profits realized by the partnership under Section 16(b) of the Securities Exchange Act of 1934 or is recovery limited to the partner-director's proportionate share of the profits?

STATUTE INVOLVED

Sections 16(a) and 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(a) and 78p(b), are reproduced in full in the Appendix to the Petition (Pet. 30a, 31a).

STATEMENT

The stock of Tide Water Associated Oil Company ("Tide Water") is registered on the New York Stock Exchange. The petitioner brought this action on behalf of Tide Water under Section 16(b) of the Securities Exchange Act of 1934 to recover the profits realized by the firm of Lehman Brothers from purchases and sales of Tide Water stock within a period of less than six months. The complaint invoked the jurisdiction of the court under Section 27 of the Securities Exchange Act of 1934.

Lehman Brothers is a partnership and a member of the New York Stock Exchange and other stock exchanges. The firm is engaged in the investment bank-

ing business, acts as a broker in securities, and trades in securities for its own account. The members of the firm hold directorships in a number of corporations (R. 32a–33a).

During the period October 8, 1954, to November 15, 1954, Lehman Brothers purchased for its own account 50,000 shares of Tide Water common stock (R. 43a–44a, 49–50a). On December 8, 1954, it converted these shares into a like amount of Tide Water preferred stock (R. 86a). The district court held that these acquisitions of the preferred stock constituted a "purchase" within the meaning of Section 16(b) (R. 156a). Lehman Brothers sold the preferred stock at a profit of $98,686.77 within six months of these acquisitions (R. 87a, 156a).

The respondent, Joseph A. Thomas, was both a partner of Lehman Brothers and a director of Tide Water during the period when all the above transactions took place (R. 5a, 25a). Prior to the purchases, Thomas had spoken "very highly of the management and prospects of" Tide Water to the partner of Lehman Brothers who authorized the firm's purchase of Tide Water common stock (R. 69a–70a). However, when Thomas learned of the first purchases, he instructed the other partners that he would not participate in any of the firm's profits from these transactions (Pet. 4a–5a).

After a trial without a jury, the district court dismissed the complaint as against Lehman Brothers and entered judgment against Thomas in the amount of $3,893.41, which represented his proportionate interest in the partnership profits from the transactions

involved. No interest was allowed by the court (R. 158a). The court of appeals affirmed by a divided court (Pet. 2a–22a).

REASONS FOR GRANTING THE WRIT

The adoption by Congress of the Securities Exchange Act of 1934 (15 U.S.C. 78a, *et seq.*) was the result of the most extensive congressional study ever conducted of stock exchange and over-the-counter practices and abuses. One of the reforms which the Congress found to be urgently needed for the protection of the investing public is embodied in Section 16 of the Act, which seeks to discourage speculation by fiduciaries in shares of their own companies. The need for the measure was clearly stated in one of the Committee reports (S. Rep. No. 1455, 73d Cong., 2d Sess., p. 55):

> Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others.

Accordingly, Section 16(a) was drafted to require disclosure of all changes in ownership of equity securities by "[e]very person who is directly or indi-

rectly the beneficial owner of more than ten per centum of any class of any equity security * * * registered on a national securities exchange, or who is a director or an officer of the issuer of such security." Section 16(b) was originally drafted to impose liability where trading occurred on the basis of inside information. Because of the anticipated difficulty of proving in each case whether confidential information had actually been used, it was ultimately decided to eliminate that requirement and use a "rule of thumb" imposing liability on the officers, directors, and ten-percent shareholders who profit from buying and selling, or selling and buying, the equity securities of their corporations within a six-month period, regardless of their subjective intent.[2]

The court below has previously ruled on the question whether Section 16(b) encompasses all of the "short-swing" profits realized by a partnership of which a director is a member. In *Rattner* v. *Lehman,* 193 F. 2d 564 (C.A. 2), which also involved the respondent partnership (or its predecessor), the court held that liability extended only to the proportionate share of a partner-director's interest in his firm. The court's opinion stated that it was not necessary to determine "[w]hether the result might be different" had the partner caused the firm to make the short-swing transactions (193 F. 2d at 565). That case was decided by then Chief Judge Swan, and Judges Learned Hand and Augustus N. Hand. In a concurring opinion, Judge Learned Hand made it clear

[2] See Hearings before the Senate Committee on Banking and Currency, 73d Cong., 2d Sess., pursuant to S. Res. 84, 72d Cong., and S. Res. 56 and S. Res. 97, 73d Cong., p. 6557.

that he assumed "that Lehman Brothers bought and sold the shares without any advice or concurrence by" the partner-director and added that he was "not prepared to say" that "if a firm deputed a partner to represent its interests as a director on the board, the other partners would not be liable" (*id.* at 566, 567).

In the present case, Judge Medina noted that he and Judge Swan disagreed with the implication in Judge Hand's concurring opinion. He stated: "* * * we do not see how any sort of deputizing can make the partners of the partnership a 'director' within the meaning of Section 16(b)," but he indicated that this conclusion was not essential to their decision (Pet. 6a–7a). He also noted that the partner-director "had provided no confidential information whatever" (Pet. 4a), and did not even know that the partnership was considering the transaction. He held that the amount of profits recoverable from a partner-director must be "the share of the profits to which he would be entitled, irrespective of any waiver or disclaimer by him," stating that if "the director himself can escape by the mere device of a waiver and disclaimer, we shall have opened a breach in the law through which stockbrokers and investment banking houses, those most likely to be in a position to profit by the use of confidential information in stock speculation, can pass with impunity" (Pet. 10a–11a).

Judge Swan joined in the decision to dismiss as against all the partners who were not directors but dissented from the decision so far as it included the profits of the partner-director which arose from

shares purchased after the latter's withdrawal from participation in partnership profits (Pet. 13a–14a).

Judge Clark was of the view that, since all the partners were co-owners of the stock in which the transactions occurred, they could not "be excluded from the operation of the statute without a serious distortion of its terms" (Pet. 17a). He pointed out that any "subjective standard of proof" forces the very step which Congress had intended to avoid.

We submit that these five different opinions by the judges who have considered this question in the court below indicate the need for review by this Court, particularly since this very important section has never been before this Court.

While the courts have generally interpreted Section 16(b) so as to carry out the legislative intention "to squeeze every possible penny of profit out of such [short swing] transactions" (Pet. 10a),[3] the decision in

[3] See *Smolowe* v. *Delendo Corporation*, 136 F. 2d 231, 239 (C.A. 2), certiorari denied, 320 U.S. 751; *Park & Tilford* v. *Schulte*, 160 F. 2d 984, 988 (C.A. 2), certiorari denied, 332 U.S. 761; *Gratz* v. *Claughton*, 187 F. 2d 46, 50 (C.A. 2), certiorari denied, 341 U.S. 920; *Blau* v. *Mission Corp.*, 212 F. 2d 77, 81 (C.A. 2), certiorari denied, 347 U.S. 1016; *Stella* v. *Graham-Paige Motors Corp.*, 232 F. 2d 299, 307 (C.A. 2), certiorari denied, 352 U.S. 831; *Adler* v. *Klawans*, 267 F. 2d 840, 847 (C.A. 2); *Blau* v. *Allen*, 163 F. Supp. 702, 704 (S.D.N.Y.); *Arkansas Louisiana Gas Co.* v. *W. R. Stephens Investment Co.*, 141 F. Supp. 841, 847 (W.D. Ark.); Cf. *Green* v. *Dietz*, 247 F. 2d 689 (C.A. 2); *Magida* v. *Continental Can Co.*, 231 F. 2d 843 (C.A. 2), certiorari denied, 351 U.S. 972; *Walet* v. *Jefferson Lake Sulphur Co.*, 202 F. 2d 433 (C.A. 5), certiorari denied, 346 U.S. 820; *Fistel* v. *Christman*, 133 F. Supp. 300 (S.D.N.Y.); *Lockheed Aircraft Corp.* v. *Campbell*, 110 F. Supp. 282 (S.D. Cal.); *Blau* v. *Hodgkinson*, 100 F. Supp. 361 (S.D.N.Y.); *Grossman* v. *Young*, 72 F. Supp. 375 (S.D.N.Y.).

this case has given only token effect to that legislative purpose by allowing recovery of only a fraction of the "short-swing" profit realized by the partnership. Where inside information is obtained from a partner director and used as a basis for a firm's trading, there is a great opportunity for the kind of unfair profits that the Congress has tried to eliminate.

To deprive the partner of only the share of partnership profits which he would normally receive is an ineffective deterrent to a partnership's trading on inside information. A partner who sacrifices his profit in one series of transactions would be compensated in whole or part from profits made in transactions by the firm in shares of other companies, in which some other partners are directors. The Commission's public records disclose that the 23 partners of Lehman Brothers hold over 100 directorships (SEC File No. 801–364), many of which are in companies registered on national securities exchanges. A study conducted in 1956 found that members of the 19 largest investment banking firms in the country held 254 positions as officers or directors in one or more of 1,642 of the nation's largest industrial companies.[4]

Accordingly, the easy evasion permitted by *Rattner* and the decision below represents a serious departure from the usual judicial treatment of the broadly remedial provision of Section 16(b) and, if allowed to stand, would virtually nullify the statute's effectiveness in a most crucial area of operation.

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[4] See Report of the House Select Committee on Small Business, 85th Cong., 1st Sess., pp. 74–81.

As Judge Clark pointed out, the decisions below substantially eliminate the great Wall Street trading firms from the statute's objectives. These firms, like much of the securities industry, are customarily organized as partnerships and, as we have noted, their partners often hold directorships in the nation's largest listed companies. With their giant resources, this group has not only the maximum opportunity, but the greatest temptation, to engage in the vice which the statute was designed to eliminate. Since the decision below would have the practical effect of substantially eliminating these firms from the application of the statute, we agree with Judge Clark that there is "unfair discrimination" of great significance.

While the interpretation of federal statutes is not dependent upon state law, we must assume that in adopting the statute the Congress was not unmindful of basic partnership concepts that are part of the fabric of the common law. A partner-director has no separate interest in specific partnership assets; he has an undivided interest in the partnership profits. The partnership is responsible for the acts of its partners in carrying out firm business. We need not urge that Thomas' directorship made the firm a "director" within the meaning of Section 16(b), but it cannot be seriously contended that a partner's directorship is unrelated to firm business in view of the recurring pattern reflected in the study referred to above.[5]

[5] See also *Lehman v. Civil Aeronautics Board*, 209 F. 2d 289, 294 (C.A. D.C.).

The courts within the Second Circuit, which encompasses the nation's largest financial community and the center of the country's securities industry, have decided a majority of the cases involving Section 16(b). Decisions in that circuit are, therefore, particularly important to the operation of this statute.

## CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be granted.

Respectfully submitted.

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